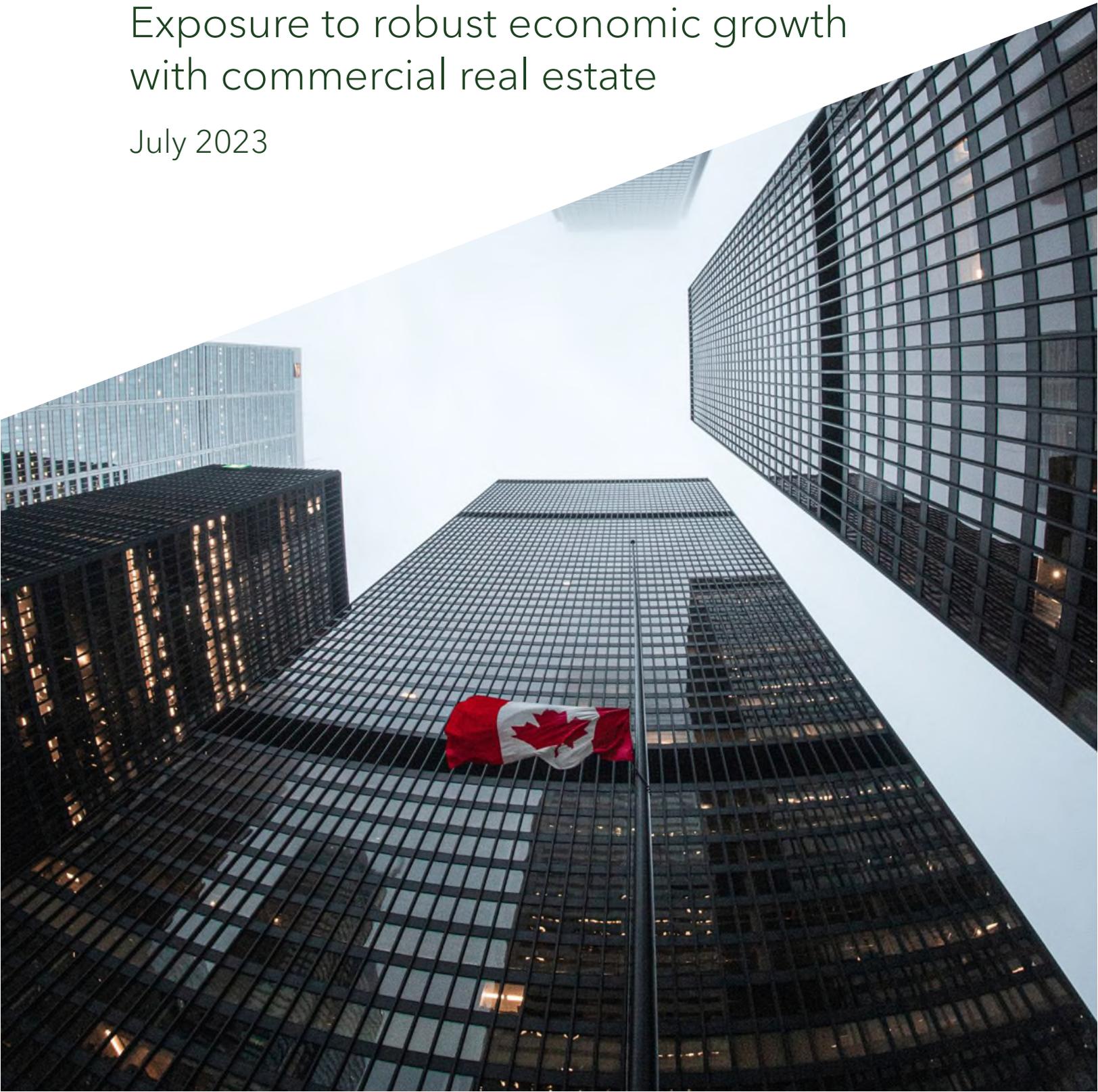




# Canada: The Quiet Giant

Exposure to robust economic growth  
with commercial real estate

July 2023



## Key takeaways:

The size of Canada's economy and commercial real estate (CRE) market demands serious consideration from global investors who could be overlooking an important part of the global landscape.

- Canada is the seventh largest CRE market in the world
- Canada is poised to outperform many advanced economies over the medium term
- Canadian CRE offers diversification to other key global markets, including the U.S.

## Canada: The Quiet Giant

Overlooked by many investors, Canada represents a significant portion of the economic and commercial real estate (CRE) landscape. Somewhat unexpectedly, Canada has the tenth largest economy in the world. Because of its size and advanced stage of economic development, Canada also possesses the seventh largest CRE market in the world. That makes it an important market for investors to consider, especially those looking to broadly allocate and diversify an international portfolio. Canada's CRE market offers relatively low correlation with other key CRE markets, especially the US.

Moreover, Canada stands poised to outperform many peer countries across a variety of metrics over the medium term, most notably GDP growth. How can Canada accomplish this and what does it mean for CRE investment opportunity there? The following is a non-exhaustive list, of key factors that separate Canada from its advanced-economy peers.

### Largest commercial real estate markets:

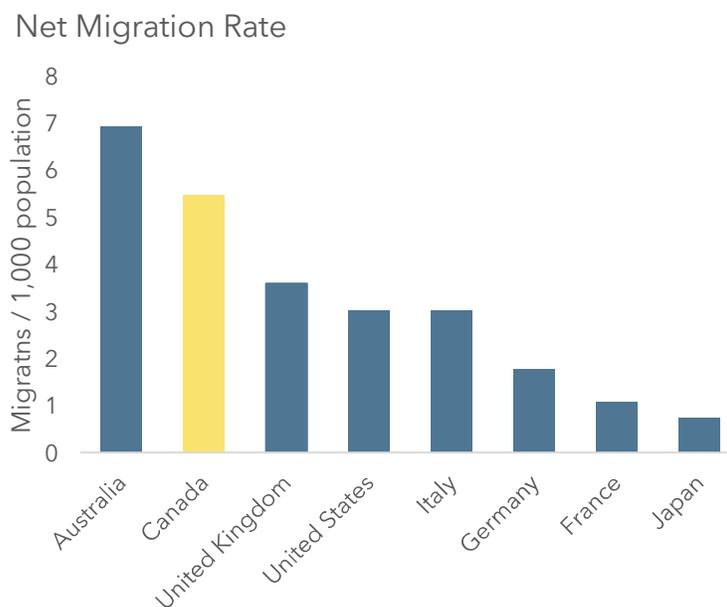
1. *United States*
2. *Japan*
3. *United Kingdom*
4. *China*
5. *Germany*
6. *France*
7. **Canada**
8. *Australia*
9. *Hong Kong*
10. *Switzerland*

Source: MSCI Real Assets, 2022

# A model for smart immigration policy

Arguably, shrewd immigration policy represents Canada's biggest macro strength. Many have touted its approach to immigration as a model for other advanced economies. Canada accomplished this with a policy that sees most immigrants arrive through economic pathways via federal high-skilled worker programs. Many candidates apply through a point system that rewards younger workers, especially those with job offers or high levels of education, experience, and language proficiency. This program enables Canada to attract high-caliber workers at a time when: (1) slow population and workforce growth is hampering many developed economies; and (2) several advanced economies are turning against immigration. That provides Canada with a competitive economic advantage because labor remains the main input to production.

It proves especially important now because productivity growth remains at low levels across the developed world. That leaves labor force growth (mainly via population growth) as the key driver of economic growth. In advanced economies the birth rate has fallen below the replacement rate, which means that the population, and ultimately the labor force, would contract without immigration. Canada goes to comparatively great lengths to help immigrants assimilate into the population by providing them with orientation, skills training, social services, and pathways to citizenship, facilitating their entry into the labor force. As a result, by one Boston Consulting Group study, Canada usurped the U.S. as the top destination for migrant labor, the first time that the U.S. has not occupied the top spot. Smart immigration policy is providing Canada with a robust source of labor and represents a key driver of economic outperformance vis-à-vis other advanced economies.



Source: CIA World Factbook, 2022

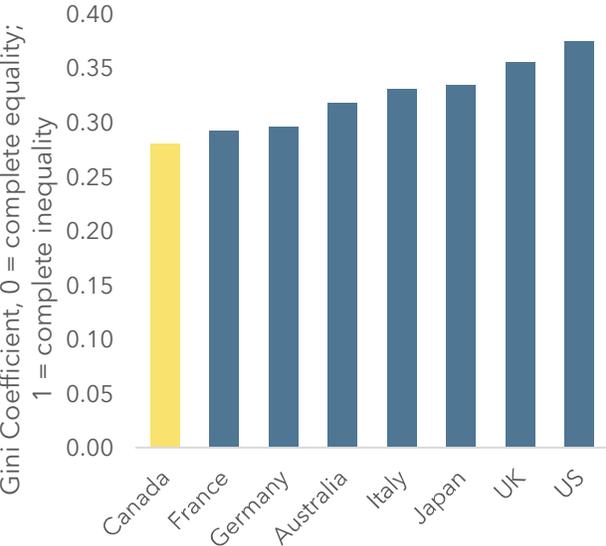


# Education key to reducing inequality

Canada ranks as the most educated country in the world as measured by the percentage of population with a post-secondary degree. Canada excels at both educating its population (both native-born and immigrant) and attracting educated immigrants. In the modern economy, education remains of great importance. Highly educated workers prove more productive, generating high GDP per capita. Moreover, Canada's more widespread educational attainment reduces inequality and provides it with

one of the lowest Gini coefficients (a measure of inequality) among major developed economies.

## Income Inequality



Source: OECD, 2020

Research shows that countries with greater equality grow faster than countries with lower equality. Why? Because inequality undermines education opportunities and outcomes for children from poor socioeconomic backgrounds. That restrains their ability to contribute positively to the economy. Moreover, they frequently require greater financial support from the state which in turn diverts resources away from potentially more productive uses. Therefore, having an educated population creates a positive feedback loop as children of educated parents go on to attain more positive education outcomes, enabling a more equal society and a more productive economy.



## Energy security is paramount

Canada remains a major global energy power. Canada gets its energy from a variety of sources and is a significant producer of natural gas, hydroelectricity, crude oil, and other energy-related liquids. More than 80% of its electricity is produced from clean energy sources such as hydroelectric and nuclear. Additionally, it ranks among the top 4 producers of petroleum and other related liquids and ranks fourth in proven oil reserves in the world. This provides Canada with ample domestic energy supplies. And because of this abundance, Canada remains a major net energy exporter.

Canada's status as a major energy producer and exporter puts the nation in a strong position to benefit from Europe's transition away from Russian energy sources. Although most of Canada's energy exports head to the U.S., it could benefit directly or indirectly as other energy sources step in to usurp Russian energy exports to Europe. That would also provide a boost to GDP. Most of Canada's peer economies do not contain such abundant energy resources. In many of those countries even attempting to extract traditional sources of energy proves unpalatable to the population. At a minimum Canada's abundant energy resources help to insulate its economy against rising energy costs. But they typically enable exports and the related economic growth that many peer economies lack.

### Top producers of crude oil:

1. *United States*
2. *Russian Federation*
3. *Saudi Arabia*
4. **Canada**
5. *Iraq*

### Largest net oil exporters:

1. *Saudi Arabia*
2. *Russian Federation*
3. *Iraq*
4. **Canada**
5. *United Arab Emirates*

Source: IEA, 2021

## Access to global markets

Canada also benefits from its position as a free-trading economy. Research shows that countries open to international trade grow faster, innovate, improve productivity, and provide higher incomes and opportunities for its people. But it isn't just the fact that Canada is a trading nation, but the magnitude by which it trades. While several of Canada's peers maintain some free-trade agreements, Canada remains the only member of the G7 with a free-trade agreement with the U.S., further enabling the largest bilateral trading relationship in the world. That provides Canada with a competitive advantage versus many of its peers that possess no free-trade agreement with the largest economy and consumer market (by real value) in the world. Moreover, this is occurring during a period of pushback against globalization, as demonstrated by the decline in the global trade-to-GDP ratio during the last 15 years.

The acceleration of onshoring, nearshoring, and friend-shoring of production in a post-pandemic world will likely further push back against widespread global trade in favor of regional trading blocs such as the USMCA trade agreement between the U.S., Mexico, and Canada. And Canada's advantage looks set to strengthen in the coming years. As some manufacturing relocates from other parts of the world to North America, the supply chain there is shifting from an East-West orientation to a more North-South orientation. Relatedly, the first major railroad merger in more than two decades was recently approved when Canadian Pacific bought Kansas City Southern. That created North America's first transnational railroad company which will bring single-line service to many key markets and further facilitate and reorient the flow of goods on the continent.



# CRE Implications

But how do those economic advantages translate into meaningful benefits in the CRE market? As a procyclical asset class, CRE benefits from economic growth. On the demand side of the market, a growing economy produces more jobs, stronger income growth, and higher corporate profits. Those factors generate demand across property types, especially the discretionary property types. While nondiscretionary property types such as multifamily and industrial possess a more consistent, durable base of demand, stronger economic growth creates greater demand for the more discretionary property types like office, retail, and hotel. That produces more abundant opportunities for investors across property types and consequently across the risk-reward spectrum.

On the supply side, a growing economy also stimulates an expansion of CRE supply. But for an economy and market as developed as Canada's that stimulus produces only marginal inventory change, not significant upheaval on the supply side of the market. In Canada this manifests as incremental net increases in inventory growth, typically in the key markets such as Toronto, Vancouver, and Montreal where supply growth remains constrained. That prevents unbridled new supply growth from weakening space-market fundamentals and limiting investment returns, as tends to happen in relatively unconstrained markets such as those found in the southern U.S. Economic dynamism also creates diverse investment opportunities through repositioning or redevelopment of existing inventory (as older inventory becomes uncompetitive or obsolete) and development of new inventory. Such changes also present new investment opportunities across the risk-reward spectrum, from existing assets to brand new properties.



# Conclusion

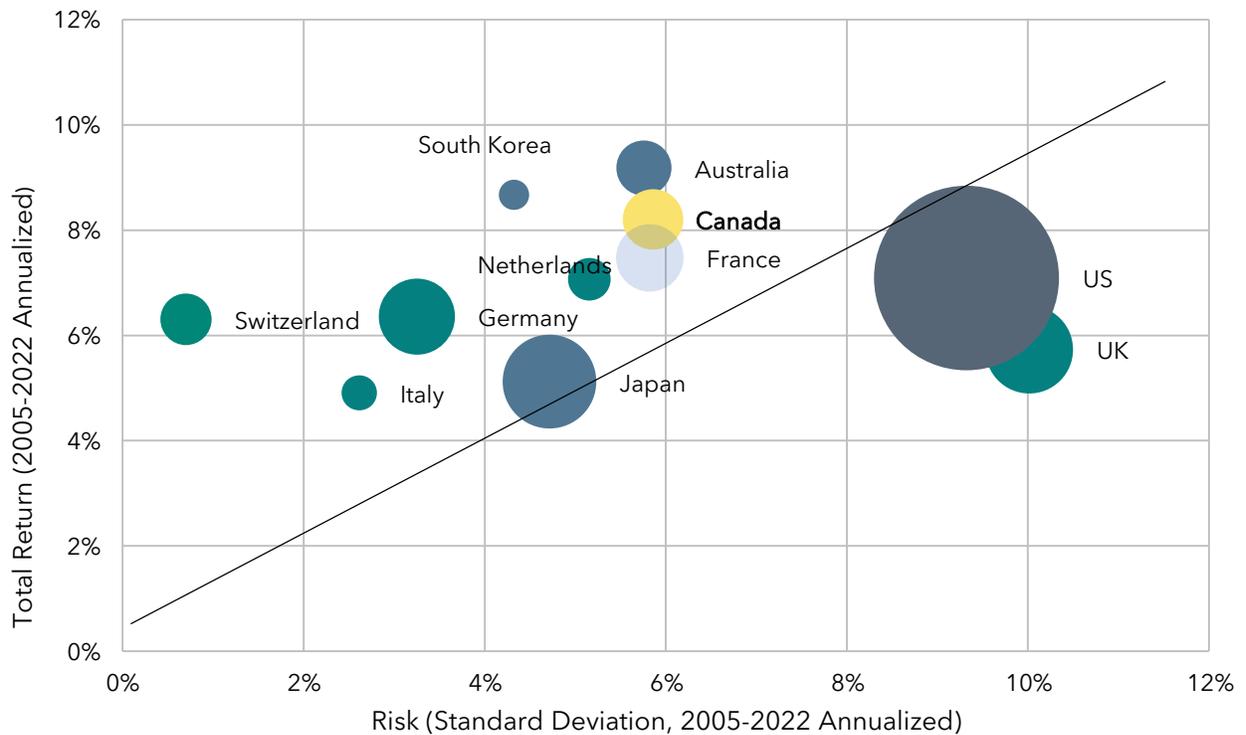
Clearly, the size of Canada's economy and CRE market demands serious consideration from global investors who could be overlooking an important part of the global landscape. But the dynamism of its expanding economy makes its CRE useful and valuable. This stems partially from the demand and supply dynamics mentioned above, but empirical research and numerous economic models demonstrate how rates of economic growth and rates of return are linked. Therefore, Canada's forecasted economic growth portends attractive relative returns for assets, including CRE, versus peer economies. Canada's CRE market presents compelling opportunities for investors looking for both attractive return opportunities and pure diversification benefits.

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*the size of Canada's economy and CRE market demands serious consideration from global investors*

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Global Real Estate Returns / Risk (2005-2022)



Source: MSCI Global Annual Property Index, local currency, size of bubble indicates estimated investible market size

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